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How The Market's Recent Rally Created 'A Good Widening' Of Closed-End Discounts

The 'Good Widening': Rob Shaker on Why Bigger CEF Discounts Right Now Are Actually a Buy Signal

Rob Shaker
Portfolio Manager
Shaker Financial Services

Chuck Jaffe, in this episode of The NAVigator podcast, interviewed discount-capture investor Rob Shaker, Portfolio Manager at Shaker Financial Services. Rob says that while closed-end fund discounts have widened through a strong season of earnings and a market returning to flirt with new highs, much of that action has been "good widenings," where a fund's net asset value goes up more than the price of the closed-end fund itself. With the market "snapping around" with heightened volatility, Shaker says that the indexes have been pulling up faster than closed-end funds can move, creating attractive buying opportunities. While liking that potential for gains, Shaker says that closed-end funds generally "have been pretty laid back," without much fear but also without much optimism, even as the market has resumed its climb higher.

TOPICS DISCUSSED

- How "good widening" — when a fund's NAV rises faster than its price — differs from the "bad widening" caused by panic selling
- Why market volatility and lag between indexes and closed-end funds is creating pricing inefficiencies to exploit
- How to spot "stale offers" left behind when the broader market moves quickly late in the trading day
- Why diversification cushions closed-end funds from single-stock shocks like an IBM or Alphabet earnings surprise
- Why discounts have stayed flat and range-bound since April, reflecting "cautious optimism" rather than fear
- Why fixed-income closed-end funds remain a holding-pattern play amid uncertainty over the Fed's next move on rates

The discussion is educational in nature and intended to help investors and advisors better understand the tools, trade-offs, and data points involved in evaluating income-focused strategies.

EXPLORE THE DATA REFERENCED IN THIS INTERVIEW:

- Free CEF & BDC profile pages: cefdata.com
- 40+ CEF & BDC indexes: cefdata.com/index

Powered by CEFData, offering transparent data on U.S. listed closed-end funds, BDCs, interval funds, and ETFs

THE CONVERSATION

CHUCK JAFFE

We're talking about closed-end fund discounts with Rob Shaker of Shaker Financial Services, welcome to The NAVigator.

This is The NAVigator, where we talk about all-weather active investing and plotting a course to financial success with the help of closed-end funds. The NAVigator is brought to you by the Active Investment Company Alliance, an industry organization that represents the entirety of the closed-end fund business from investors and users up to fund managers, sponsors, and creators. If you're looking for excellence beyond indexing, The NAVigator will point you in the right direction.

And today we're looking to capture discounts or make the right discount plays with Rob Shaker, portfolio manager at Shaker Financial Services. You can learn about him and the firm online at ShakerFinancial.com. And you can learn more generally about closed-end funds, interval funds, and business-development companies at AICAlliance.org, that's the website for the Active Investment Company Alliance.

Rob Shaker, great to have you back on The NAVigator.

ROB SHAKER

Good to talk with you.

CHUCK JAFFE

Closed-end funds and their discounts are all about emotion and how investors are feeling, and it's been a really interesting market because markets back to or at record highs, discounts however are showing that maybe investors are still worried. And Lord knows, I said the other day to somebody, "Someday somebody's going to look back and go, look at this great stretch of market run, was that amazing?" And people will go, "Yes, it was." "How did you feel when you went through it?" "Oh, miserable. Horrible every day."

So are we seeing the sentiment show up in the discounts at this point? And what is that doing for you as an investor?

ROB SHAKER

A bit of background, at Shaker Financial we focus in on our core strategy of discount capture, and in doing discount capture, the first step is to buy the funds when they're artificially wide, right? And as you sort of point out there in your question, they're a little wide right now. And that might bring up the issue of, okay, why are they wide now? We've often talked in the past about times in which there's a lot of excessive selling pressures and so things get wide, because there are two ways that things can get wide.

One is if the price goes down more than the NAV does, that's the traditionally excessive selling, the carnage widening, everyone's fearful so they're selling bonds when they shouldn't be, and so that's mostly what people think about when they think there's widening. But then there's what my co-portfolio manager Dan Gordon calls the "good widening", and the good widening to us is when it widens because the NAV goes up more than the price goes up, so the price is going up but the NAV is just going up more. What we've seen recently is that sort of phenomenon going on as you have the recovery back up.

CHUCK JAFFE

How common is that in terms of what kind of market conditions do we have? Because again, we're living with a market that's at record highs, but it's been around record highs for a while, so this hasn't been the condition you've been seeing that recently, right?

ROB SHAKER

While it's at record highs, it kind of got there in a choppy way, and it's the volatility that's really the key here, because even though it has been near or at record highs, nothing really worrying about, no corrections, it's been snapping around. And so when it snaps down to the downside, it takes a little bit of that extra scare like we had in March like, oh, maybe this is a big one, right? But when it snaps up, it's more of just the lag. And so what you saw sort of over the last three or four days even, earlier in the week, is when the markets go up strong, you have a big up day, the indexes pull things up a lot faster than the slower things, specifically closed-end funds.

So for example, on Tuesday of this week we had a big up day, our average equity was up a little bit more than a percent. Great day, everyone should be happy, right? And you might think, okay, well, that's not a day I want to buy things, but the average NAV, as it turns out, was up about 1.4%, and so that means on average all our closed-end funds widened about a third of a percent. But that's what we call the good widening, the one we're going to get paid back for in the future, and it wasn't because of anything frightful.

But you can imagine if our average widened a third, then individually, and if you're really looking around, you probably were able to get really good deals on things just weren't up that much as their NAVs were soaring along with this market that's just spiraling up maybe half a percent towards the last hour of trading.

CHUCK JAFFE

So what that basically means is the prices are going up and you're still getting not just the regular discount but you're getting the discount on how much the prices were just raised.

ROB SHAKER

Exactly, and sometimes if you're really focused in and you're watching, fortunately for our clients, I guess, but unfortunately for us, we just stare at the screen all day. If you're watching like that, you'll see, you can see what we call a stale offer.

So if the markets move, and sometimes they do, especially in these types of volatilities, they might move a half a percent in the last 30 minutes of trading, you might see a decent sized offer on a typical closed-end fund that's an equity fund that's just sitting there and it sat there the whole time. So it may have been up, maybe a buy at 3:15, but at 3:45, oh, now it's a buy, and it's still sitting there so we'll clean it up.

CHUCK JAFFE

Given this market, and obviously we've had a couple of days where you could see that happening, but have you had a lot of what obviously then has to be considered the bad kind of widening? And the bad kind of widening would be IBM, as an example, has that huge down day, so it drops, NAVs drop, but again not as much.

So are you looking going, wow, if this gets oversold on the market, my discount's about to get hammered? And does that matter to you, because you're a discount capture investor, if you think the discount's wide enough, I wouldn't think it would scare you that it got a little bit wider? But you wouldn't like it on any given day where you're going, okay, my closed-end fund didn't get punched in the mouth today but it will tomorrow.

ROB SHAKER

Right, and you bring up a great point of beyond just the overall volatility, this earnings season has really pointed out individual volatility of a given stocks. I can't remember which one was up, it was one of those days and it was Alphabet down 10% and Meta up 10% or vice versa. And so one of the beautiful things about closed-end funds is that they're diversified, right?

So take the IBM example that you brought up, IBM has a huge down day, so what's that going to mean to closed-end funds? Well, at one level, not that much because they're all sort of diversified, so we don't have to worry about that individual impact of what SpaceX just did or anything like that, we just have more of a minimum. But per each given fund, it might have a bigger effect, and it might be one that people don't know about. And so at SFS, we're fortunate enough that we've spent the time to create models for all the NAVs given the recent reporting of what each fund holds.

The funds will report what they hold quarterly at least, and so you can look on a day like that and say, "Oh, I see that this fund had a lot of IBM," so even though it's down way more than the market, it's not really a buy. And so sometimes when you have those individual outliers, especially in widely held things like Apple or any of these Mag Sevens, it's important to know which ones are doing things. We have an expression, "You've got the wrong guy, Sledge," and that's when somebody is sledging down one of these funds, thinking that it's down a lot but not knowing that it had the one that was up that day, and so we're more than happy to buy it back from them.

CHUCK JAFFE

Given what we've seen with the market that has climbed back towards record highs, what have you seen in terms of discount trends? You said there's a lot for you to be buying right now, but the trend in discounts, is it just because you're seeing that widespread good widening or is it more that discounts have been a little too big given where the market's been?

ROB SHAKER

Well, on a broader scale, and it always depends when you're looking at one of these charts, how closely you focus in, how wide you zoom back, how much of the left side you cover. And so recently, even though we've had a lot of noise since April, discounts are pretty flat, they've had some bumps but closed-end funds in general have been pretty laid back. There hasn't been a lot of fear, there hasn't been a lot of optimism or excessive optimism. So we had the big drop in March when people were a little scared, and then we came back, not all the way but most of the way, and now we've just sort of been treading there.

So I wouldn't say that it's necessarily pointing towards any sort of fear, but I'd say it's more on the cautious optimism. I think closed-end fund investors are for the most part a little bit more conservative in terms of really believing that everything's going to go perfectly from here on out, and so you get that first set of news, "Oh, they're going to reach a ceasefire," "Oh, everything's going to be fine," "Oh, they're not going to have to raise rates."

I think closed-end fund investors are a little bit more “show me”. And so waiting around until we really get the stability for bond funds to know that they’ve got the level that they’re going to have for a while, things will be steady there and they can just count their coupons, I think, will be helpful.

CHUCK JAFFE

A lot of closed-end fund activity is not on the equity side, we’ve got yields that have gotten high, especially on longer term bonds. What are you seeing in terms of discount activity there? And is there an area of fixed-income that you like better than others right now?

ROB SHAKER

Fixed-income has been pretty steady this year, even though rates are going higher. So rates have risen, and there is some sense and some thoughts that they might go higher, especially if inflation isn’t handled a little bit better over the next couple of months here. But the high rates are actually in the long run good for the closed-end funds, because they’re collecting these coupons at a nice clip but it’s just not been the year in which we’re getting the almost double-digit returns on the bond funds and we’re getting closer to 4 or 5% returns as of now.

So I think they’re all a little undervalued, the discounts didn’t fully recover from the sell-off in March, but I think that’s an area in which we really are more waiting for some certainty. The certainty is really clutch for bond investors, the concept that they could really raise rates or aggressively go after inflation is I think in the back of peoples’ minds. It’s not the full TINA, there is no alternative, fled and fleeing from bond funds like we had back in the early 2010s, but there’s still a little bit of, “Okay, well, let’s just wait and see and make sure that we’re not going to have an aggressive Fed.” But in that interim, they’re still doing just fine.

CHUCK JAFFE

Yeah, so what that means is you’re more of a holder than you are a buyer. You bought things that were well positioned and you’re riding with them as opposed to repositioning, right?

ROB SHAKER

Yeah, and I think that a nice spattering of diversification there, I don’t think you can really bank on it. High yields are a very good place, from where I stand, if you’re not really worried about huge defaults or a recession, which I don’t think most are, but you also have some senior loans in case rates do go up. Just the spattering I think is always good because you just don’t know where the pressures are going to come from next, and so we just keep that balance going.

CHUCK JAFFE

Well, and you keep hoping that you'll get more of those good widenings and have it work in your favor. Rob, great stuff, always is when we catch up. Thanks so much for coming back to The NAVigator.

ROB SHAKER

Thanks for having me.

CHUCK JAFFE

The NAVigator is a joint production of the Active Investment Company Alliance and Money Life with Chuck Jaffe, and yeah, I'm Chuck Jaffe, you can check out my show on your favorite podcast app or you can go to MoneyLifeShow.com.

If you want to check out more information on closed-end funds, interval funds, and business-development companies, go to AICAlliance.org, that's the website for the Active Investment Company Alliance.

Thanks to my guest, Rob Shaker, he's portfolio manager at Shaker Financial Services, and if you want to learn more about the firm and how they invest and what they do, go to ShakerFinancial.com.

The NAVigator podcast has something new for you every Friday, so make plans to join us again next week for some more closed-end fund fun. And if you don't want to miss an episode, make sure you're following us on your favorite podcast app. We'll see you again next week, and until then, happy investing, everybody.

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